

**DEPARTMENT OF STATE REVENUE****LETTER OF FINDINGS NUMBER: 97-0470****Corporate Income Tax****For Years Ending 6/27/93, 7/3/94, and 7/2/95**

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES****I. Adjusted Gross Income Tax – foreign source dividend expense.**

**Authority:** Ind. Code § 6-3-2-12;  
Ind. Code § 6-8.1-5-1.

The taxpayer protests the amount of foreign source dividend expense in the audit report.

**II. Adjusted Gross Income Tax – Michigan Single Business Tax.**

**Authority:** First Chicago NBD Corp. v. Department of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999).

The taxpayer protests the add-back of the Michigan Single Business Tax in determining its Indiana adjusted gross income.

**STATEMENT OF FACTS**

The taxpayer is based in the state of Wisconsin and is engaged primarily in the manufacture of small gasoline engines. The taxpayer's activity in Indiana is limited to a minor tooling operation for one of the taxpayer's divisions. A corporate income tax audit was completed on March 7, 1997. The auditor determined that the taxpayer had deducted the entire amount of its foreign source dividend income. In accordance with Departmental policy, the auditor reduced the total foreign source dividend income by 15% as direct expenses. The taxpayer protests the 15% direct expense presumption as being "arbitrary and capricious."

The auditor, in accordance with Departmental policy at the time of the audit, added back the taxpayer's deduction of the Michigan Single Business Tax (MSBT) it had paid. The taxpayer protests the add-back, maintaining that the MSBT is a value added tax, not an income tax.

**I. Adjusted Gross Income – foreign source dividend expense.****DISCUSSION**

The audit report indicates that the taxpayer had a total of \$11,858,312 in foreign source dividend income during the three year audit period. The auditor determined that fifteen percent (15%) of that figure, i.e. \$1,778,746, was direct expenses attributable to earning the dividend income. The taxpayer protests this direct expense amount as being grossly out of line with its own estimate of expenses as well as being arbitrary and capricious.

In Indiana, “[t]he notice of proposed assessment is *prima facie* evidence that the department’s claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.” Ind. Code § 6-8.1-5-1(b). Foreign source dividend income is fully deductible “if the corporation that includes the foreign source dividend in its adjusted gross income owns stock possessing at least eighty percent (80%) of the total combined voting power of all classes of stock of the foreign corporation from which the dividend is derived.” Ind. Code § 6-3-2-12(c). The Department finds that the auditor was correct in determining that fifteen percent (15%) of all deductible foreign source dividend income is attributable to direct expenses and, therefore, not deductible. However, upon further review of the taxpayer’s federal Form 1118, the Department finds that, in this particular case, twelve percent (12%) of deductible foreign source dividend income attributable to direct expenses is more accurate. This amount is rebuttable upon presentation by the taxpayer of acceptable proof that a lesser amount is attributable to direct expenses.

The taxpayer submitted proof in the form of an estimate of what its annual direct expenses would be. The taxpayer assumed that it would take an accountant no more than a day each year to record the receipt of the dividends to a dividends received account. Assuming that the accountant is paid \$50,000 per year, one day’s worth of time would be approximately \$191 in expenses, rounded to \$200. Another expense that the taxpayer has in earning the foreign source dividends is the cost of wire transfers. The taxpayer estimates that ten wire transfers are made per year in connection with the dividends at a cost of \$25 each, for a total of \$250 per year. According to the taxpayer, the expenses for one year equal \$450, or \$1350 for the three year audit period. This is, however, only a partial representation of what constitutes direct expenses. Per the instructions for Form 1118, such expenses include stewardship expenses, legal and accounting expenses, and other expenses related to certain supportive functions such as overhead, general and administrative, advertising, and marketing. The taxpayer has not presented sufficient proof of its actual total direct expenses to rebut the Department’s finding that twelve percent (12%) of the taxpayer’s dividend income is attributable to direct expenses.

**FINDING**

The taxpayer’s protest is partially sustained in that the percentage of foreign source dividend income attributable to direct expenses is reduced from fifteen percent (15%) to twelve percent (12%).

**II. Adjusted Gross Income – Michigan Single Business Tax**

**DISCUSSION**

The Indiana Tax Court has determined that the Michigan Single Business Tax (MSBT) is not a tax measured by income. First Chicago NBD v. Department of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999). Consequently, the MSBT tax paid by the taxpayer should not be added back in determining the taxpayer's Indiana adjusted gross income.

**FINDING**

The taxpayer's protest is sustained.